

This letter discusses nexus. See Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992). (This is a GIL.)

August 22, 2006

Dear Xxxxx:

This letter is in response to your letter dated February 9, 2005, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We represent a client ('Company A') who desires a written legal opinion with respect to the application of sales and use tax in your state with regards to the following transactions:

## **BACKGROUND**

Company A is a retailer and wholesaler of tangible personal property. Company B, a retailer and wholesaler of tangible personal property, desires to enter into an agreement with Company A such that Company A will provide one of the following services:

### **Service #1 – Distribution Services**

Company B has merchandise which it wishes to distribute and sell. Company B would like to hire Company A to supply order processing, customer service, credit and collections, data processing, shipping, and warehousing services. We note that Company B's products are not sold by Company A and Company B may sell its products via other distribution channels. These services are described as follows:

- Order processing – Company A will accept and process orders placed via Company B's website, mail order, telephone or fax. Payments by check are made out to Company B c/o Company A. Payments by credit card will show

Company A's name and 800 telephone number as reflected by the credit and collections service provided by Company A. Invoices or receipts will reflect Company A's name and address but will also state on the invoice that the invoice includes merchandise from Company B. It is possible that the invoice will include merchandise from Company A and Company B.

- Customer service – Any merchandise returned by customers will be sent to Company B, c/o Company A at Company A's address.
- Credit and collections – Billing and collections activity will be performed under Company A's returns and collections policies. Company A will determine granting of credit to Company B customers under its own credit policies. Company B may at its own risk override Company A's credit hold decision on a specific account and grant credit for Company B's own merchandise in writing. Company A will use all reasonable efforts to collect on Company B's accounts consistent with efforts made to collect from its own customers, including but not limited to using collection agencies and attorneys. Company A will provide on-line access to records which document collection efforts made by Company A to collect on delinquent Company B accounts.
- Data processing and Inventory Management – Company A will provide sales, royalty, direct mail, customer mailing list, inventory, A/R and other reports to Company B. Company A will count incoming merchandise and report actual numbers as well as any damaged goods received, promptly so that Company B can adjust figures on vendors' invoices. Company A will not release incoming merchandise from inventory until written authorization is received from Company B. Company A will apply Company B's write-down policy to Company B's inventory at the end of each month and provide a report showing revised inventory values.
- Shipping – Company A will ship all Company B's orders with postage based on purchase amount for direct mail and individual orders charged to customers. For all other customers, the actual postage is billed to them. Company A primarily ships by trackable means unless the customer accepts responsibility if shipped by an alternate method.
- Warehousing – Company A will store, care for and provide warehouse space for all Company B merchandise. Company B will ship its merchandise to Company A's warehouse. Insurance on Company B's inventory while warehoused at Company A's warehouse will be the responsibility of Company B. There is no requirement for Company A to insure any of Company B's inventory, however, Company A has the responsibility to provide reasonable care and accountability for Company B's inventory at Company A's facilities. Company A does not take title to Company B's merchandise.
- Fees and other conditions – Company A's fee for these services provided will be a percentage of net sales of Company B's products fulfilled by Company A. Company A will forward a check for all monies collected for Company B for each month.

Upon termination of this distribution agreement, Company B will remove its inventory from Company A warehouses. Payment by Company A to Company B will be continued until all outstanding receivables are transferred to Company B for collection. Subsequent payments after transfer of outstanding receivables will be promptly forwarded to Company B. Company A will deliver electronic files containing all Company B data stored by Company A to Company B within thirty (30) days.

Editorial, production, design, marketing, sales, pricing, subsidiary rights, and contractual matters remain strictly the province of Company B. Company A's obligations under this distribution agreement are limited solely to the warehousing, distribution, and other services and activities as described. Any additional distribution activities undertaken by Company B must first be approved by Company A.

Company B will provide copies of its catalogs, price lists, brochures, and other information as reasonably requested by Company A to enable Company A to perform its obligations under this distribution agreement.

Nothing contained in the distribution agreement shall be construed to place the parties in the relationship of partners or joint ventures, it being agreed and understood that Company A is an independent contractor and is not an agent or employee of Company B. Company A shall have no power to obligate or bind Company B in any manner whatsoever.

## **Service #2 – Exclusive Distribution, General Marketing and Sales Services Agreement**

In addition to the services provided above, Company A will also provide promotion, publicity, advertising and sales representation. Company A will be the sole and exclusive distributor of Company B's merchandise but does not take title to such merchandise.

Such promotion, publicity and advertising services include:

- Inclusion in catalogs which are mailed to customers as well as used in personal sales calls by representatives and agents of Company A.
- Company B's products will be listed on Company A's website.
- Company B's products will be included in special promotions and events with Company A's products.

Company A's fee for these services provided will be a percentage of net sales of Company B's products fulfilled by Company A.

## **QUESTIONS**

1. Based on the facts described above, which party (Company A or B) would your state consider to be the retailer and thus subject to a sales and use tax registration and filing requirement for Service #1 and Service #2?
2. Would your answer to Question #1 be different, if:
  - a. Only Company A is registered or has sufficient nexus in your state for sales and use tax registration purposes?

- b. Only Company B is registered or has sufficient nexus in your state for sales and use tax registration purposes?
  - c. Both Company A and B are registered or have sufficient nexus in your state for sales and use tax registration purposes?
3. Would your answer to Question #1 or #2 be different, if the property was shipped from a warehouse located in your state?
4. Would your answer to Question #1 or #2 be different, if the property was shipped from a warehouse located outside of your state?

Thank you for your consideration in this matter. Should you have any questions, I may be reached at #.

## **DEPARTMENT'S RESPONSE:**

Determinations regarding the subject of nexus are normally very fact specific. The Department has found that the best manner to determine nexus is for a Department auditor to examine all relevant facts and information. The following guidelines, however, may be useful to you. An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax law. The Supreme Court has set out a two-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis will trigger Use Tax collection responsibilities. See Brown's Furniture, Inc. v. Wagner, 171 Ill.2d 410 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the

out-of-State goods and have a duty to self-assess their Use Tax liability and the customer must remit the amount directly to the State. The Use Tax rate is 6.25%.

In general, the imposition of the various sales taxes related local taxes in Illinois are triggered when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115.

The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred. Although 86 Ill. Adm. Code 270.115 deals with the municipal Home-Rule taxes, the principles outlined in this regulation apply to all local taxes administered by the Department.

If a purchase order is accepted outside the State, but the property being sold is located in the retailer's inventory in an Illinois jurisdiction that has imposed a local tax (see, for example, Section 270.115(b)(3)), then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Terry D. Charlton  
Senior Counsel  
Sales & Excise Tax  
Legal Services Office

EEB:msk